ALLIED FARM EQUIPMENT, INC.

ANNUAL REPORT 1970

Fellow Shareowners:

As indicated to you in our Nine Months Report, 1970 was a year of a major retrenchment program and substantial inescapable net losses for Allied.

The fiscal year ended Oct. 31, 1970 resulted in a total net loss of $1,198,668 or $1.21 per share as compared with prior year earnings of $4,545 or less than one cent per share.

This major operating deficit—the first in our history—was the cumulative result of a five year expansion program, and the cost of adjusting that structure to meet realities of a new market climate in farm equipment. Although soundly based, this expansion of a highly profitable farm implement distribution organization and diversification into manufacturing was accomplished—in hindsight—at precisely the wrong time, in view of the sharp and extended downturn in our markets.

Essentially this meant that an organization structured to handle more than a $30 million volume in 1970 found itself faced with far lesser prospects. In total, our 1970 sales were $24,420,018, down from $29,008,976 in 1969.

As with other farm implement companies, this decrease was brought on by a substantial downturn in demand caused by heavy wheat surpluses in grainbelt areas and other problems that seriously impaired farmer buying power, plus tight credit and high interest costs that affected our dealer-customers.

At the same time, we faced a cost/price squeeze on our gross margins, slower collections on receivables and higher interest costs. In addition, we faced these factors: (a) the costs involved in phasing out the manufacturing operations cited below; (b) costs of consolidating our distribution network; (c) special write offs which we made in a year when a deficit already loomed inevitable. On the other hand, fortunately, as indicated in the footnotes, we had a substantial gain on Canadian dollar revaluation.

* * *

In brief, Allied wasted no more time in lamenting its misfortunes, but moved rapidly to return the organization to its former structure of a profitable, trim farm equipment company.

In early spring, Allied began an intensive program which included a re-budgeting and detailed analysis of each operating unit, all aimed at producing tough-minded, comprehensive new operating plans to align Allied squarely with present realities.

By late spring, a financial and operating plan to return the company to sound profitability had been detailed for an 18 month period which can be summarized as follows:

OBJECTIVES

The following five primary objectives were identified as the key short term goals for the Company:

1. To reduce receivables and inventories from the April, 1970 level of approximately $28,000,000 to a fiscal year-end level of approximately $23,000,000 and a level of approximately $17,500,000 by the end of fiscal 1971.

2. To reduce operating expenses from the 1968-69 level of $6,100,000 to approximately $5,800,000 in 1969-70 and to $4,400,000 in 1970-71.

3. To reduce the scope of the Company's sales and distribution operations to the point where sales would be decreased from approximately $29,000,000 in 1968-69 to between $25,000,000 and $26,000,000 in 1969-70 and to approximately $23,000,000 in 1970-71.

4. To effectively reduce manufacturing operations by the end of fiscal 1971.

5. To reduce interest costs by reducing short term loans and trade payables approximately in ratio to cuts in inventory and receivables.

STRATEGIES

To enable the Company to achieve these objectives, the following basic changes in operations were undertaken:

1. A consolidation and streamlining of distribution operations resulted in a reduction in distribution operating divisions from 9 to 6 with a resultant substantial overhead decrease.

2. By the end of the fiscal year, the number of distribution warehouses has been reduced from 25 to 18.

3. The number of salesmen has been trimmed from 93 to 73 and sales operations in the Canadian maritime provinces, the southeastern United States and the Pacific northwest have been sharply contracted.

4. Corporate headquarters staff has been reduced by approximately 50%, to a total of 16.

5. Manufacturing activities have been discontinued at Nashville, Georgia and reductions in the level of manufacturing activity at our remaining plants in Manhattan, Kansas and Winnipeg, Canada have been accompanied by substantial reductions in manufacturing overheads. Further consolidation of manufacturing activities in 1971 is being programmed to achieve the manufacturing objectives of our plan.

6. To help meet the very real liquidity problems prevailing during fiscal 1970, improved systems and techniques in inventory and receivable control and reduction were introduced, and further improvement in procedures is programmed for 1971.

* * *

The last six months of 1970 saw substantial achievement of the drastic operating changes called for in our plan. These changes could not be achieved without substantial 1970 P&L effect (particularly when coupled with unusually early and unusually dry harvest conditions which shut off Allied's harvest equipment sales far earlier than normal). Nevertheless, Allied has, in large measure, completed the necessary adjustments to present conditions.

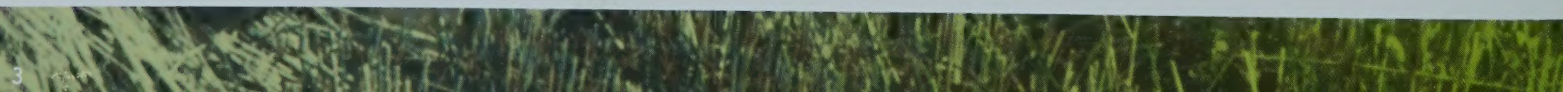
CURRENT OUTLOOK

Entering the new fiscal year, Allied remains the largest short-line distribution organization in North America, consisting of 6 consolidated distribution divisions with 18 warehouses, covering all of Canada and 38 states of the U.S. Weeding out unprofitable product lines, our distribution efforts now operate on behalf of a total of approximately 40 major franchisor-suppliers and encompass about 95 separate product lines, down 20% from 1969. It should be noted that available to this streamlined organization is a $1,500,000 tax-loss carryforward that can be credited against our potentially obtainable earnings in the upcoming years.

With the remaining changes for 1971 being confined largely to the manufacturing area, Allied has entered 1971 far better prepared and organized than at any time in recent years, to do a sound, professional job as a stable, effective sales and marketing organization in the specialty farm equipment field. I am pleased to note that first reports on current operations support this view.

James I. Kanter

JAMES I. KANTER
President



Consolidated Balance Sheets

OCTOBER 31, 1970 AND 1969

Assets

	1970	1969
Current assets:		
Cash	$ 528,022	$ 486,061
Receivables, less allowance for doubtful accounts: 1970, $352,000; 1969, $350,000 (Notes 2, 4 and 6)	10,538,824	10,774,287
Inventories, lower of cost (first-in, first-out) or market (Notes 2 and 4)	12,594,491	12,895,555
Recoverable income taxes (Note 3)	298,300	248,524
Other	215,930	223,818
Total current assets	24,175,567	24,628,245
Property and equipment, at cost (Note 4):		
Land	192,142	200,047
Buildings	1,108,388	1,162,458
Machinery and equipment	2,096,982	2,041,587
	3,397,512	3,404,092
Less accumulated depreciation	1,579,040	1,372,239
	1,818,472	2,031,853
Other assets and deferred charges:		
Cash value of life insurance, less policy loans	18,292	80,462
Long-term receivables	25,731	29,460
Patents and trade names, less accumulated amortization	71,620	78,514
Debenture, term loan and registration financing costs, less accumulated amortization	108,195	127,207
Other	275,277	259,513
	499,115	575,156
	$26,493,154	$27,235,254

Liabilities

	1970	1969
Current liabilities:		
Notes payable (Notes 2 and 4):		
Banks	$ 9,023,019	$ 9,944,544
Others	2,850,845	325,358
Current portion of long-term debt	828,346	458,349
Accounts payable	3,232,417	3,799,266
Accrued liabilities	650,384	893,793
United States and Canadian income taxes	62,294	55,677
Total current liabilities	16,647,305	15,476,987
Long-term debt (Note 4)	6,647,119	7,334,744
Deferred income taxes (Note 3)	82,279	108,404
Shareholders' equity (Notes 4 and 5):		
Class A common stock, $1 par value; authorized 2,000,000 shares; outstanding: 1970, 991,819 shares; 1969, 856,017 shares	991,819	856,017
Class B common stock, $1 par value; authorized 1,000,000 shares; outstanding: 1969, 135,802 shares		135,802
Capital in excess of par value	570,313	570,313
Retained earnings	1,554,319	2,752,987
	3,116,451	4,315,119
	$26,493,154	$27,235,254

The accompanying notes are an integral part of the financial statements.

Consolidated Statements of Income and Retained Earnings

FOR THE YEARS ENDED OCTOBER 31, 1970 AND 1969	1970	1969
Sales	$24,420,018	$29,008,976
Cost of sales	18,307,506	21,594,645
	6,112,512	7,414,331
Selling, general and administrative expense	5,860,418	6,101,682
Interest expense, net	1,594,318	1,299,400
	7,454,736	7,401,082
Income (loss) before income taxes and extraordinary items	(1,342,224)	13,249
Provision (credit) for income taxes:		
Current	(150,731)	(3,700)
Deferred	7,175	12,404
	(143,556)	8,704
Income (loss) before extraordinary items	(1,198,668)	4,545
Extraordinary items:		
Gain on repurchase of 6% Convertible Subordinated Debentures less taxes of $16,000		19,032
Indemnification for loss of a franchise less taxes of $43,000		47,000
		66,032
Net income (loss)	(1,198,668)	70,577
Retained earnings, beginning of year	2,752,987	3,013,080
Stock dividends, 5% (including $2,020 cash in lieu of fractional shares)		(330,670)
Retained earnings, end of year	$ 1,554,319	$ 2,752,987
Earnings per share (Note 7):		
Income (loss) before extraordinary items	$(1.21)	$ —
Extraordinary items	—	0.07
Net income (loss)	$(1.21)	$0.07

Consolidated Statements of Capital in Excess of Par Value

FOR THE YEARS ENDED OCTOBER 31, 1970 AND 1969	1970	1969
Balance, beginning of year	$ 570,313	$ 288,613
Excess of market value over par value of shares issued in payment of 5% stock dividend:		
24,275 Class A shares		145,650
22,675 Class B shares		136,050
Balance, end of year	$ 570,313	$ 570,313

Consolidated Statements of Source and Use of Funds

FOR THE YEARS ENDED OCTOBER 31, 1970 AND 1969	1970	1969
Source of funds:		
Net income (loss) for the year	$(1,198,668)	$ 70,577
Add charges to income which did not require current cash outlay:		
Depreciation (principally straight-line method)	278,331	286,660
Deferral of income taxes, net	(26,125)	36,417
Decrease (increase) in other assets and deferred charges, net	76,041	(140,386)
	(870,421)	253,268
Use of funds:		
Net additions to property and equipment	64,950	258,304
Reductions of long-term debt	687,625	514,877
Payment of cash in lieu of fractional shares on 5% stock dividend		2,020
	752,575	775,201
Decrease in working capital	$ 1,622,996	$ 521,933
Working capital at year-end (excess of current assets over current liabilities)	$ 7,528,262	$ 9,151,258

The accompanying notes are an integral part of the financial statements.

Notes to Financial Statements

1. Principles of Consolidation and Foreign Exchange: The financial statements include the accounts of Allied Farm Equipment, Inc. and all subsidiaries (which are all wholly-owned).

The net assets of the Canadian subsidiaries (in U.S. dollars) totaled $3,794,041 at October 31, 1970.

The financial statements of the Canadian subsidiaries have been translated into U.S. dollars as follows: current assets and current liabilities at exchange rates prevailing at the end of the period; long-term debt and fixed assets on the basis of rates prevailing at date of acquisition; income and expenses at average exchange rate during the period. Net gains from such translation practices amounting to $184,000 and gains from fluctuations in the exchange rate during the year amounting to $308,000 are reflected in the consolidated statement of income.

2. Notes Payable, Banks and Others: At October 31, 1970 accounts receivable and inventories of certain subsidiaries totaling $8,275,908 and $8,812,082, were pledged as collateral for bank indebtedness totaling $9,023,019. In addition, principal officer/shareholders of the company have pledged as collateral for certain of these loans $605,000 principal amount of municipal bonds.

Accounts receivable and inventories of the company and United States subsidiaries totaling $2,614,916 and $2,777,167 at October 31, 1970 are pledged as collateral for notes payable to others totaling $2,073,477.

Also see Note 4 for certain subordinated security interests in accounts receivable and inventories.

3. United States and Canadian Income Taxes: The tax credit arising from the current year's net operating loss is limited to recoverable income taxes under carryback provisions of applicable jurisdictions. The remaining net operating loss carryover of the United States companies is approximately $1,300,000 and expires in 1975.

Deferred income taxes are principally the result of differences in the timing of expense deductions for financial statement and tax purposes. Such timing differences result from the use of accelerated depreciation and the current deduction of certain development expenditures and other items for tax purposes.

4. Long-Term Debt: Long-term debt consists of:

	Portion Due Within One Year	Portion Due Beyond One Year
(a) 6% Convertible Subordinated Debentures	$ 79,400	$1,000,000
(b) Term loans	118,800	1,582,600
(c) Purchase contracts	426,568	3,771,129
(d) Mortgages and other notes payable	203,578	293,390
	$828,346	$6,647,119

(a) 6% Convertible Subordinated Debentures: The Debentures are subordinate for payment to any Senior indebtedness, as defined in the Indenture, amounting to approximately $13,040,000 at October 31, 1970. They may be redeemed, in total or from time to time in part, at prices decreasing from 103 percent on or before February 28, 1971 to prices reducing by one-half percent in each six-month period thereafter until par. The Indenture requires retirement of the Debentures at 100 percent plus accrued interest through a Sinking Fund in the principal amount of $100,000 in each of the years 1971 through 1979, and $200,000 at maturity. Each $100 Debenture is convertible at any time into Class A common shares of the company at $10.06 per share. Limitations on the payment of cash dividends are more restrictive under the Term Loan Agreements than under the Indenture.

By virtue of additional security interests extended to other long-term creditors in February, 1971, the Debenture holders have been granted, equally and ratably with such other creditors, a junior security interest in all United States accounts receivable and inventory, and a security interest, equally and ratably with such other creditors in 25 percent (but no more than $500,000 in liquidation proceeds) of certain Canadian inventories.

At October 31, 1970, Debentures in the principal amount of $20,600 were held by the company to apply against the 1971 Sinking Fund requirement.

(b) Term Loans: The company is indebted to Teachers' Insurance and Annuity Association of America ("TIAA") under two Loan Agreements, the principal provisions of which are as follows:

Principal balances	$821,400	$880,000
Interest rate	6¾%	6⅞%
Annual principal maturities:		
1971	58,800	60,000
1972	55,800	60,000
Years 1973 through 1980	88,350	95,000
Annual prepayment privileges in whole or in part, in any multiple of $50,000 beginnng in	1970	1971
Premium on prepayment decreasing annually through 1979	6¼ to 1%	6⅜ to 2%

Under the most restrictive provisions of the agreements, as amended in February, 1971, the company is required among other things, to:

(i) maintain consolidated net working capital of at least $6,000,000 and a current ratio of at least 1.30 to 1. At October 31, 1970, net working capital was $7,528,262 and the current ratio was 1.45.

(ii) maintain consolidated tangible net worth, as defined, of at least $2,000,000 to March 31, 1971 and $2,150,000 thereafter. At October 31, 1970, consolidated tangible net worth, as defined, was $2,661,359.

(iii) maintain accounts receivable and inventory of at least 160% to March 31, 1971 and 175% thereafter of all bank, finance company and TIAA debt collateralized by such accounts receivable and inventory. Such receivables and inventories were 174% of such debt and borrowings at October 31, 1970.

(iv) restrict borrowings from banks on accounts receivable and inventories pledged to amounts which shall not exceed 120% of accounts receivable to March 31, 1971 and 110% thereafter. Such borrowings were 102% at October 31, 1970.

(v) limit the payment of dividends (other than stock dividends), any other distribution on its shares and payment of principal amounts of the Frick purchase contract notes to 50% of the consolidated net earnings of the company after October 31, 1970.

The February, 1971 amendments to the agreements modified certain of the companies' covenants under which the company would have been in default as at October 31, 1970 and subsequent, had such modifications not been entered into.

The amendments became effective under a Modification Agreement which contained amendments, modifications and waivers similar to amendments, modification and waivers affecting similar covenants under the Frick note agreement referred to below. In connection with the modification agreement, the company granted TIAA a junior security interest, equally and ratably with the debentures and Frick notes, in all United States companies' accounts receivable and inventory and a security interest, equally and ratably with the debentures and Frick notes in 25% (but no more than $500,000 in liquidation proceeds) of certain Canadian inventories.

(c) Purchase Contracts: In 1968, the company acquired the farm implements businesses of McCune & Company Incorporated and Frick Company. Notes in the principal amount of $208,620 with interest at 1% above the applicable discount rate (which was 6% at October 31, 1970) of the Chicago Federal Reserve Bank were issued in connection with the McCune purchase. Notes in the principal amount of $4,420,848 with interest at 6¾% (and 9% on overdue installments effective September 1, 1971) and warrants to purchase 157,538 shares (adjusted for a 5% stock dividend paid in 1969) of the Class A common stock of the company were issued in connection with the Frick purchase.

The note balances are payable as follows:

	McCune Notes	Frick Notes
1971	$21,000	$406,000
1972 and 1973, each at	21,000	265,000
1974, 1975, 1976 and 1977, each at	21,000	774,000
1978	21,000	

The Frick note agreement which contains restrictive provisions substantially the same as those contained in the TIAA agreements was also modified in February, 1971 to include the principal amendments described above including the modification of certain of the company's covenants which would have been in default at October 31, 1970, and subsequent. In addition, the agreement, as amended, provides the following for years beginning November 1, 1970:

(i) in the event that the principal payment on the Frick notes in any year is less than 25% of the scheduled payment for such year, or if the aggregate of principal payments in any two consecutive years is less than 70% of scheduled payments for such years, the entire principal balance of the notes will become due. If the principal payment in any year is less than 50% of the scheduled payment, or the aggregate of principal payments in any two consecutive years is less than 75% of the aggregate of scheduled payments for such years, Frick may require certain shareholders of the company to elect such designees of Frick as may be necessary to elect a majority of the Board of Directors of the company (see above for limitations on principal payments).

(ii) the Warrants granted to Frick may be exercised at a price of $3.00 per share, in whole or in part, until one year after the entire principal amount of the notes has been paid, but in no event later than August 31, 1983. A proportionate amount of the Warrants will be cancelled upon each full payment of principal amounts of the notes, until 30 percent of such Warrants (47,261 shares) are cancelled by this method. The Warrants may be exercised by payment of cash or by cancellation at par of principal amounts due under the notes (allocated in proportion to principal amounts of scheduled payments). As of October 31, 1970, 9,452 Warrants have been cancelled.

(iii) indebtedness to the parent company from its Canadian subsidiaries shall not exceed $3,000,000 after February 15, 1971 nor shall its direct investment in such subsidiaries exceed the amount held as of June 30, 1970.

(iv) Frick notes are subordinated to the Term Loans described above.

In connection with the modification of the Frick note agreement, the company granted a junior security interest, equally and ratably with the debentures and TIAA debt, in all United States companies' accounts receivable and inventory and a security interest, equally and ratably with the debentures and TIAA debt in 25% (but no more than $500,000 in liquidation proceeds) of certain Canadian inventories.

(d) Mortgages and Other Notes Payable: Property and equipment with a book value of $977,673 are pledged as collateral for mortgages and other notes payable totaling $496,968. Interest rates are from five and one-half percent to nine percent per annum and principal amounts of the notes are payable in installments maturing as follows:

	Approximate Annual Maturities
During the years ending October 31:	
1971	$204,000
1972	103,000
1973	73,000
1974	15,000
1975	17,000
Total payments thereafter through 1983	85,000

5. Shareholders' Equity: On October 30, 1970, the 135,802 shares of Class B common stock were converted into a similar number of Class A common shares.

The $1,079,400 of 6% Convertible Subordinated Debentures are convertible into 107,296 shares of Class A common stock to March 1, 1971. In addition, see Note 4 relative to outstanding warrants to purchase Class A common stock of the company.

The company has reserved 49,612 shares of its authorized but unissued Class A common stock for issuance under the company's 1965 stock option plan for key employees. The option price may not be less than the fair market value at the date of grant; options may be exercised in installments of 25 percent of the shares during each of the second through the fifth year after date of grant on a cumulative basis. At October 31, 1970, options for 23,822 shares (presently exercisable as to 7,425 shares) had been granted and were outstanding. Changes during the year ended October 31, 1970 in options outstanding are summarized as follows:

	Number of Shares	Option Price Range
Outstanding, October 31, 1969	35,675	$5.71-7.62
Granted	23,750	1.00-3.25
Cancelled and expired	(35,603)	1.00-7.62
Outstanding, October 31, 1970	23,822	1.00-7.62

6. Commitments and Contingent Liabilities: The company and its subsidiaries occupy manufacturing and office space under various leases maturing between 1971 and 1978, which require the payment, in addition to property taxes, insurance and maintenance, of aggregate rentals of $995,000. Annual rentals for 1971 through 1976 reduce from $208,000 to $68,000.

Lease option agreements provide for the purchase of a plant at July 31, 1974 at an initial price of $502,200, reducing at an annual rate of $11,044 from November 1, 1964.

The company is required to take back equipment and repurchase accounts receivable under a financing arrangement in the event that its customers have failed to sell the equipment and remit the proceeds by the maturity date of the related receivables. Unpaid invoices subject to these terms amounted to $249,650 at October 31, 1970.

7. Earnings Per Share Data: Earnings per share is calculated on the basis of a weighted average of the aggregate of Class A and Class B shares outstanding during the period.

Accountants' Report

To the Directors and Shareholders
Allied Farm Equipment, Inc.
Chicago, Inc.

We have examined the consolidated balance sheet of Allied Farm Equipment, Inc. and subsidiaries as of October 31, 1970 and the related consolidated statement of income and retained earnings, the consolidated statement of capital in excess of par value and the consolidated statement of source and use of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the consolidated financial statements of the company and subsidiaries for the year ended October 31, 1969. We did not examine the financial statements of the company's subsidiary, Allied Farm Equipment, Inc., a Delaware corporation, which statements were examined by other certified public accountants whose report thereon has been furnished to us. Our opinion expressed herein is based upon our examination and upon the aforementioned report of other accountants.

In our opinion, the aforementioned financial statements present fairly the consolidated financial position of Allied Farm Equipment, Inc. and subsidiaries at October 31, 1970 and October 31, 1969 and the consolidated results of their operations and source and use of funds for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Chicago, Illinois
February 8, 1971

Lybrand, Ross Bros. & Montgomery
Certified Public Accountants

Officers:

James I. Kanter, President
Solomon Kanter, Vice President
Alexander J. Kanter, Vice President & Treasurer
Samuel M. Kane, Secretary

Directors:

Samuel M. Kane
Alexander J. Kanter
James I. Kanter
Solomon Kanter
John S. Malmgren, President, Excel Manufacturing Ltd.
Richard E. Petersen, Management Consultant

General Counsel:

Baker & McKenzie
Prudential Plaza
Chicago, Ill.

Special Counsel:

Kane and Kane
10 S. La Salle Street
Chicago, Ill.

Certified Public Accountants:

Lybrand, Ross Bros. & Montgomery
141 W. Jackson Boulevard
Chicago, Ill.

Transfer Agents:

The First National Bank of Chicago
Montreal Trust Company (Winnipeg Branch)

Trustees:

(Debentures)
The American National Bank and
Trust Co. of Chicago

ALLIED FARM EQUIPMENT, INC.

ALLIED FARM EQUIPMENT
UNITED STATES:

Allied Farm Equipment, Inc. (Illinois)
Corporate Office
Chicago, Illinois
Mid-West Division—
J. J. Jeffers, Gen. Mgr.
Belvidere, Illinois

Branches:
Bloomington, Minnesota
Waukee, Iowa
Springfield, Illinois
Indianapolis, Indiana

Wholly Owned Subsidiaries
Allied Farm Equipment, Inc. (Oregon)
Western Division—
R. E. Blinn, Gen. Mgr.
Stockton, California

Allied Farm Equipment, Inc. (Kansas)
Viking Manufacturing Division—
R. J. Buzenberg, Gen. Mgr.
Manhattan, Kansas

Allied Farm Equipment, Inc. (Delaware)
Eastern Division—
W. H. Cockshutt, Gen. Mgr.
Youngstown, Ohio

Branches:
Columbus, Ohio
Syracuse, New York
Nashville, Georgia

CANADA:

Allied Farm Equipment (Ontario) Ltd.
Eastern Canada Division—
J. Westmoreland, Gen. Mgr.
St. Marys, Ontario

Branch:
Pointe Claire, Quebec

Allied Farm Equipment (Manitoba) Ltd.
Manitoba-Saskatchewan Division—
E. V. Paskewitz, Gen. Mgr.
St. Boniface, Manitoba

Branches:
Regina, Saskatchewan
Saskatoon, Saskatchewan

Winnipeg Manufacturing Division—
E. V. Paskewitz, Gen. Mgr.
St. Boniface, Manitoba
Alco Equipment Division—
E. V. Paskewitz, Gen. Mgr.
Winnipeg, Manitoba

Branch:
West Fargo, North Dakota

Allied Farm Equipment (Alberta) Ltd.
Alberta & British Columbia Division—
D. W. Samman, Gen. Mgr.
Calgary, Alberta

Branches:
Edmonton, Alberta
Richmond, British Columbia